INITIAL DECISION RELEASE NO. 392

ADMINISTRATIVE PROCEEDING
FILE NO. 3-13579

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

In the Matter of	:	
	:	
	:	INITIAL DECISION
JAMES C. DAWSON	:	December 18, 2009
	:	

APPEARANCES: Richard G. Primoff and Charles D. Riely for the Division of Enforcement, Securities and Exchange Commission

Michael Martinez and Adam C. Ford, Kramer Levin Naftalis & Frankel LLP, for James C. Dawson

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

Procedural History

The Securities and Exchange Commission (Commission) initiated this proceeding on August 12, 2009, pursuant to Section 203(f) of the Investment Advisers Act of 1940 (Advisers Act). The Order Instituting Proceedings (OIP) alleges that James C. Dawson (Dawson) has been acting as an investment adviser to Victoria Investors, L.P. (Victoria Investors), since 1982 and that, on July 24, 2009, the United States District Court for the Southern District of New York (District Court) enjoined Dawson from future violations of Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), Exchange Act Rule 10b-5, and Sections 206(1) and 206(2) of the Advisers Act; ordered him to disgorge $303,472, plus pre-judgment interest of $102,975; and ordered him to pay a $100,000 civil penalty. SEC v. Dawson, No. 08-CV-7841 (PGG).

Dawson admitted in his Answer to the OIP, that he was the subject of a permanent injunction. (Answer at 1.) He declined to admit or deny the other allegations in the OIP. (Id.)

At a prehearing conference on September 14, 2009, I granted the Division of Enforcement's (Division) uncontested request to file a motion for summary disposition.

(Prehearing Tr. 5.) See 17 C.F.R. § 201.250. The Division filed its Motion for Summary Disposition, Memorandum of Law in Support of its Motion for Summary Disposition, and Declaration of Charles D. Riely, with Exhibits A through D, (Motion) on October 19, 2009. Exhibit A is a copy of the Complaint in Dawson; Exhibit B is the Final Judgment, filed July 24, 2009, in the same action; Exhibit C is a copy of the Consent executed by Dawson on March 20, 2009; and Exhibit D is a copy of Dawson's Answer in this administrative proceeding, dated September 3, 2009.

Dawson filed his Memorandum of Law in Opposition to the Division's Motion and a Declaration of Adam C. Ford with six Exhibits on November 25, 2009 (Opposition). Exhibit 1 consists of eleven letters from investors in Victoria Investors in support of Dawson; Exhibit 2 is an Independent Auditor's Report on Supplementary Information for Victoria Investors, dated March 15, 2005, showing annual rates of return for the period 1982 through 2004; Exhibit 3 is Victoria Investors' audited financial statements for year ended December 31, 2003; Exhibit 4 is Victoria Investors' audited financial statements for year ended December 31, 2004; Exhibit 5 is Victoria Investors' federal tax return for year ended December 31, 2005; and Exhibit 6 is a chart titled "James Dawson Compensation Analysis for 2003-2005," based on information in Opposition, Exhibits 3 through 5.

The Division filed a Reply Memorandum in Support of its Motion (Reply), dated December 11, 2009.

I admit into evidence the exhibits attached to the Division's Motion and Dawson's Opposition.

Division's Motion for Summary Disposition

The Division requests entry of an order barring Dawson from association with any investment adviser based on the injunction entered against him by the District Court on July 24, 2009. (Motion at 1, 12.) The Division argues that the Final Judgment entered by the Court in Dawson incorporated Dawson's Consent, which prohibits Dawson from contesting, in this administrative proceeding, the factual allegations in the Complaint in Dawson. (Motion at 2, Ex. C at 4.) Under the terms of the Consent that resolved Dawson, Dawson acknowledged that the entry of an injunction may have collateral consequences. (Motion, Ex. C at 4.)

Dawson's Opposition to the Motion

Dawson claims to be a talented investment adviser who, for almost three decades, has safeguarded and increased the value of his clients' investments. (Opposition at 5.) Dawson supports this claim with the statement that, in twenty-seven years, Victoria Investors has almost always outperformed the market with only two losing years, 2002 and 2008, and that, from 1982 through its last audited financial statements in 2004, Victoria Investors achieved an effective annual rate of return of 10.88 percent. (Opposition at 5, Ex. 2.)

Dawson contends that investors in Victoria Investors, all of whom are family and close friends, are reputable, knowledgeable, and well-versed in the finance industry. (Opposition at 5-

6.) He claims that he has exhibited compassion, understanding, integrity, and responsibility since starting Victoria Investors in 1982 and has put into the record letters from eleven investors supporting his request to continue participating in the investment adviser industry.[1] (Opposition at 6-7, 12, Ex. 1.)

Dawson argues that application of the Steadman factors shows that his conduct was neither egregious nor recurrent as demonstrated by the client letters offered in support. See SEC v. Steadman, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981).

Dawson claims investors did not suffer financial harm.

Victoria Investors' audited financial report as of December 31, 2003, states that Dawson is allocated an amount equal to twenty percent of the net profits allocated to the limited partners for each fiscal year. (Opposition, Ex. 3 at 7.) According to Dawson, his compensation consists of an incentive allocation equal to twenty percent of the limited partners' annual net income and the partnership agreement has no "high-water mark" so that, even if the fund were to have a losing year, he "would be entitled to an incentive allocation based on all net income that the limited partners earn in subsequent years." (Opposition at 4-5.) Dawson claims to have voluntarily reduced his incentive compensation for 2003 to 2005 by $252,403, which he asserts offsets the profits he made in his personal trading account over that period. (Opposition at 8-10.) Specifically, Dawson claims that he was entitled to $211,745 in compensation in 2003, but he voluntarily accepted only $91,776. (Opposition at 8-9.) According to Dawson, he did not "trumpet his voluntary implementation of a 'high-water mark' to [Victoria Investors'] limited partners," but did so "without fanfare."[2] (Id.) In 2004 and 2005, Dawson asserts that he voluntarily reduced his compensation by approximately $52,591 and $79,843, respectively. (Opposition at 9.) He claims that:

> [s]ignificantly, if Mr. Dawson had placed his personal trades into [Victoria Investors'] account, instead of voluntarily reducing his compensation for 2003, 2004, and 2005, his overall compensation would have been greater. . . . Thus, [Dawson's] voluntary reductions in annual incentive compensation more than offset the profits he made trading in his personal account.

(Opposition at 10.)

Dawson asserts that his voluntary deductions in compensation made his investors whole by February 2006. (Opposition at 15.) Dawson maintains that he should not be barred from

[1] Following September 11, 2001, Dawson, a former All-American basketball player and 1967 Big Ten Most Valuable Player, volunteered to serve as an assistant men's basketball coach pro bono at the John Jay College of Criminal Justice when he learned that many deceased fire and police personnel had attended that academic institution. (Opposition at 4, 7.)

[2] Dawson uses the term "high-water mark" to refer to Victoria Investors' profits in the previous year. He claims that he took incentive compensation in 2003 "only with respect to the amount by which Victoria [Investors'] profit exceeded its losses during 2002." (Opposition at 8.)

association with an investment adviser given that investors benefited from profitable returns during the period in which he wrongfully traded in his personal account and he voluntarily reduced his compensation by amounts that offset his personal trading gains. (Opposition 13-14.)

Dawson's conduct was not recurrent.

Dawson characterizes his personal trading as an aberrant two-year episode in an otherwise unblemished decades-long career. (Opposition at 14.)

Dawson did not act with a high degree of scienter.

Dawson maintains that he did not act with a high degree of scienter because he never intended to permanently deprive his family and friends of any funds and asserts that investors suffered no financial harm whatsoever. (Opposition at 15.)

Dawson has given assurances against future violations and has recognized the wrongful nature of his conduct.

Dawson considers the terms of his voluntary settlement of the civil action as establishing "the sincerity of the defendant's assurances against future violations" and "the defendant's recognition of the wrongful nature of his conduct." (Opposition at 15.)

Based on the totality of his professional life and character, Dawson urges that he receive no sanction. (Opposition at 3.) If an administrative sanction is ordered, Dawson requests that it be less drastic than a permanent bar, such as a censure, a limitation on his ability to acquire additional investors, or a suspension of up to twelve months. (Id.) Dawson claims that a bar will deprive him of the livelihood at which he has worked for decades and will effectively destroy Victoria Investors. (Id.)

Division's Reply in Support of the Motion

The Division points out that Dawson does not dispute the basis for the Motion which is that a United States District Court has entered an injunction prohibiting him from future violations of the antifraud provisions of the securities laws. (Reply at 1.) The Division notes that the Complaint in the underlying civil action states that Dawson deliberately, secretly, and unfairly allocated profitable trades to his own personal account at the expense of his clients and also used investor funds for personal expenses over a period of thirty months. (Reply at 1.)

The Division makes the following arguments:

1. The Commission's case law holds that the views of individuals are not determinative as to whether an investment adviser, who deliberately harms investors to whom he owes a fiduciary duty, should receive an associational bar. Rather, the Commission does not act to protect specific investors, but, in cases such as this, the Commission has ordered an associational bar to protect the investing public generally. (Reply at 2-3.)

2. The Division insists that it is indisputable that Dawson's clients were harmed by his deliberate misconduct, pointing to the Complaint that contradicts Dawson's claim that his "investors did not suffer financial harm." (Reply at 3; Motion, Ex. A at 2.) The Division rejects Dawson's argument that his voluntary deduction in his incentive compensation offset the proceeds he received for the fraud because: (a) Dawson's fraudulent scheme harmed his investors, which alone is determinative, making other considerations irrelevant; (b) Dawson's conduct is even more egregious because he kept his cherry-picking scheme secret, thus misleading investors as to his incentive compensation and secretly stealing investors' money while representing that they were receiving a discount on his services; and (c) the key fact that Dawson committed misconduct demonstrates that he is unfit for the securities business. (Reply at 4-5.)

3. Dawson's misconduct was pervasive and repeated, consisting of 400 trades over two and a half years. Dawson's use of his investment adviser role to enrich himself by receiving ill-gotten gains and his persuasiveness at retaining investor support increase concerns about his potential to engage in similar conduct in the future. (Reply at 6-7.)

4. The Commission has held repeatedly that conduct such as Dawson's warrants the imposition of an associational bar. (Reply at 7.)

Ruling on the Motion

Rule 250 of the Commission's Rules of Practice provides that a motion for summary disposition may be granted if there is no genuine issue of material fact and the party making the motion is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(b). I GRANT the Motion because it has been established that Dawson has been enjoined as alleged in the OIP. (Answer at 1; Motion, Ex. B.)

Findings of Fact

Dawson is sixty-four years of age. (Opposition at 4.) After graduating from the University of Illinois in 1967 and playing one year of professional basketball, he has spent his life working in the finance industry. (Id.)

As of June 2006, Victoria Investors, an unregistered hedge fund and limited partnership, had assets of approximately $13 million, and approximately twenty individual and institutional investors. (Motion at 3, Ex. A at 3.) Dawson has been the sole general partner of, and investment adviser to, Victoria Investors since 1982. (Id.) Between 2003 and 2005, in addition to Victoria Investors, Dawson also provided investment advisory services to three individual clients, with combined assets under management of approximately $2.8 million. (Id.)

UBS provided prime brokerage services to Victoria Investors since its inception. (Opposition at 8.) UBS required Dawson to submit trade allocation instructions between 4:00 p.m. and 7:00 p.m. (Id.) Dawson opened a personal account at UBS in April 2003 and placed personal trades in this account until November 2005, which resulted in total profits to him of $303,472. (Id.) From April 2003 through October 2005, Dawson secretly cherry-picked

profitable trades for his personal account at the expense of his clients to whom he owed a fiduciary obligation. (Motion at 3, Ex. A at 3, 5.) Dawson carried out his fraudulent scheme by purchasing securities throughout the day and delaying allocation to either his personal account or his clients' accounts until the end of the day, when he knew whether they had appreciated in value. (Motion at 3, Ex. A at 5.) Dawson waited until the market closed before transmitting his allocation decisions, which gave him the opportunity to allocate the more profitable trades to his personal account and the less profitable or unprofitable trades to his advisory client accounts. (Motion at 3-4, Ex. A at 5.) Dawson's fraudulent conduct earned him ill-gotten gains in the form of profits on trades in his personal account and avoided losses by allocating unprofitable trades to his clients. (Id.) For example, in this two and a half year period, 393 of the approximately 400 trades that Dawson allocated to his personal account were profitable on the first day, for a success rate of approximately 98.3 percent. (Motion at 4, Ex. A at 6.) During this same time period, 1,489 of the approximately 2,880 trades that Dawson allocated to Victoria Investors and individual client accounts were profitable on the first day, for a success rate of approximately 51.7 percent. (Id.)

Dawson had no justification for allocating the profitable trades to his account and the unprofitable trades to his clients' accounts. (Motion at 5, Ex. A at 7.) His actions were done for his profit and at his clients' expense. (Id.) There was no significant difference in the trading strategy that Dawson used for trades in his personal account and the trades he allocated to his clients' accounts. (Id.) As evidence that Dawson acted knowingly and recklessly, the Complaint described day trades, purchases and sales, where Dawson allocated the profitable trades to his personal account and the unprofitable trades to his advisory clients. (Motion at 4-5, Ex. A at 6-7.)

Dawson did not disclose his cherry-picking scheme or the resulting conflicts of interest to any of his clients.[3] (Motion at 5, Ex. A at 1, 7-8.) In November 2005, Dawson's prime broker terminated Dawson's personal account and informed Dawson that he had until the end of 2005 to transition his accounts from the prime broker. (Motion at 6, Ex. A at 5-6.) Dawson continued his fraudulent cherry-picking scheme through 2005. (Motion at 6, Ex. A at 5.) Dawson transferred his client accounts to a different prime broker in January 2006, and he continued trading for his clients thereafter. (Motion at 6, Ex. A at 6.)

Between 2003 and 2005, Dawson did not disclose to investors in Victoria Investors that he was using Victoria Investors' funds to pay for personal and family expenses, such as family cell phone bills and car service for himself and family members for non-business trips. (Motion at 6, Ex. A at 8.) Dawson did not reimburse Victoria Investors for these personal and family charges. (Id.)

Conclusions of Law

Section 203(f) of the Advisers Act provides that the Commission shall censure or place limitations on the activities of any person associated, seeking to become associated, or, at the

[3] The Division defines Dawson's cherry-picking scheme as "allocating the unprofitable trades to his client accounts, and the profitable trades to his own account." (Motion at 5; Ex. A at 7.)

time of the alleged misconduct, associated with an investment adviser, or suspend for a period not to exceed twelve months or bar any such person from being associated with an investment adviser, if it finds, after notice and opportunity for hearing, such action is in the public interest and the person is enjoined by a court from conduct or practice in connection with the activities of an investment adviser. Dawson has been enjoined from conduct performed while he was acting as an investment adviser so the issue is what, if any, sanction is in the public interest.

The Commission considers the Steadman factors in making a public interest determination:

> [T]he egregiousness of the [respondent's] actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the [respondent's] assurances against future violations; the [respondent's] recognition of the wrongful nature of his conduct; and the likelihood that the [respondent's] occupation will present opportunities for future violations.

603 F.2d at 1140.

Dawson's conduct was egregious because he was acting in a fiduciary capacity when he committed the transgressions. An investment adviser is a fiduciary, and, as such, has an affirmative duty of utmost good faith and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading its clients. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963); Tamar Frankel, 2 The Regulation of Money Managers §14.01 at 14-5 (2d ed. Supp. 2009) (An investment adviser "should . . . refrain from competing with or seizing opportunities of his beneficiary."); Restatement (Second) of Agency § 387 cmt. b (1958) (Duty as an agent includes refraining from taking "unfair advantage of his position in the use of information or things acquired by him because of his position as agent or because of the opportunities which his position affords."). Dawson's conduct was also egregious because he did not disclose to his clients that he was allocating the profitable trades to his personal account or that he was using Victoria Investors' funds for his personal and family expenses. Rather, he took the disingenuous actions of representing to investors that he was voluntarily reducing his incentive compensation from Victoria Investors between 2003 and 2005.

Dawson's actions were not isolated, but consisted of 400 individual trades that occurred over a two and a half year period.

There could not be a more blatant breach of a fiduciary duty or the exercise of a higher degree of scienter than deliberately establishing a separate account and deliberately allocating to that account trades Dawson knew were more profitable than the trades he allocated to the accounts of his clients, all of whom were family or friends.

Defendants enter consent agreements for many reasons. There is no evidence to support Dawson's argument that his Consent demonstrates he recognizes his conduct was illegal and provides assurance that he will not commit future violations. This record does not contain an acknowledgement by Dawson that his conduct was illegal or any assurances that he will not repeat his actions in the future.

Dawson's position that investors in Victoria Investors did not suffer financial harm from his conduct is inaccurate on its face since his reduction in fees was $252,403 for 2003 to 2005 and he was ordered to disgorge $303,472, representing profits gained as a result of the conduct alleged in the Complaint. (Motion, Ex. B at 2.) Victoria Investors' financials state that Dawson took advances against his estimated allocation of profits in 2001 through 2004 that ultimately caused overpayments to Dawson of $181,224 on December 31, 2003, and $134,413 on December 31, 2005. (Opposition, Ex. 3 at 7, Ex. 4 at 7.) Victoria Investors' federal tax return for 2005 shows a $124,413 advance to general partner. (Opposition, Ex. 7 at 7.)

Dawson claims that his wife is Victoria Investors' only full-time employee and that she managed approximately fifteen percent of the fund's assets and conducted research and analysis. (Opposition at 4.) However, Victoria Investors' one-room office with two desks and a facsimile machine was staffed by Dawson and a part-time employee from late 2004 until at least February 2007. (Motion, Ex. A at 4.) Mrs. Dawson was paid a "purported salary" of $144,000, $168,000, $168,000, and $182,000, respectively, from at least 2002 through 2005. (Id.)

The eleven letters from Dawson's clients, a sister and ten friends, indicate that they respect Dawson and want him to continue to manage their investments. However, the Commission's purpose is to protect all investors, and, in making public interest determinations, it evaluates the welfare of investors as a class and not the interests of a particular set of investors. See Jeffrey L. Gibson, 92 SEC Docket 2104, 2113 (Feb. 4, 2008), 561 F.3d 548, 554 (6th Cir. 2009); Conrad P. Seghers, 91 SEC Docket 2293, 2307 (Sept. 26, 2007), pet. denied 548 F.3d 129 (D.C. Cir. 2008); Christopher A. Lowrey, 55 S.E.C. 1133, 1145 n.26 (2002); Wilshire Disc. Secs., 51 S.E.C. 547, 551 n.15 (1993).

The Commission and the courts have acknowledged that the position of investment adviser is an occupation that can cause havoc unless engaged in by those with appropriate background and standards. See Benjamin Levy Secs., Inc., 46 S.E.C. 1145, 1147 (1978); Joseph P. D'Angelo, 46 S.E.C. at 736, 737 (1976); Marketlines, Inc. v. SEC, 384 F.2d 264, 267 (2d Cir. 1967), cert. denied, 390 U.S. 947 (1968). Finally, the Commission has stated that:

> The fact that a person has been "permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction" from violating the antifraud provisions has especially serious implications for the public interest. Based on our experience enforcing the federal securities laws, we believe that ordinarily, and in the absence of evidence to the contrary, it will be in the public interest to revoke the registration of, or suspend or bar from participation in the securities industry, or prohibit from participation in an offering of penny stock, a respondent who is enjoined from violating the antifraud provisions.

Marshall E. Melton, 56 S.E.C. 695, 713 (2003); Scott B. Gann, 95 SEC Docket 15818, 15823 (Apr. 8, 2009).

Based on the evidence in the record, I find that it is in the public interest for the protection of investors to bar Dawson from association with any investment adviser.

Order

In addition to granting the Motion, as noted above, based on the findings and conclusions stated, I ORDER that, pursuant to Section 203(f) of the Investment Advisers Act of 1940, James C. Dawson is barred from association with any investment adviser.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Brenda P. Murray
Chief Administrative Law Judge